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IN THE

Supreme Court of the United States

—

OCTOBER TERM, 1975

—

No. 75-1460

—

PEORIA and EASTERN RAILWAY COMPANY,
Petitioner

v.

TRUSTEES OF THE PENN CENTRAL
TRANSPORTATION COMPANY
Respondents

—

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

—

BRIEF OF RESPONDENTS, TRUSTEES OF PENN CENTRAL TRANSPORTATION COMPANY, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

—

I
OPINIONS BELOW

—

The judgment order of the United States Court of Appeals for the Third Circuit, affirming the decision of the United States District Court for the Eastern District of Pennsylvania overseeing the reorganization of Penn Central Transportation Company (Reorganization Court), is reported in *In re Penn Central Transportation Co.*, 527 F.2d 645 (3d Cir. 1976) and appears in the Appendix to the Peoria and Eastern's Petition (Pet. at A8). The opinion

of the Reorganization Court is reported at 392 F. Supp. 960 (E.D. Pa. 1975), and appears in the Appendix to Peoria and Eastern's Petition (Pet. at A1-A7).

II

QUESTIONS PRESENTED

1. Did the opinion of the Reorganization Court, which was affirmed by the Court of Appeals below, correctly characterize the status of the Peoria and Eastern under its Operating Agreement with the Penn Central?

2. Was the Court of Appeals correct in affirming the decision of the Reorganization Court which held that there was no basis for the creation of a trust to cover the payments owed by Penn Central to the Peoria & Eastern for the use and operation of the line of its railroad?

III

STATEMENT OF THE CASE

This case concerns the status of Petitioner, Peoria & Eastern Railway Co. (P&E), under an Operating Agreement with Penn Central and the effect of the Penn Central's reorganization on the rights of the P&E under the Agreement.

Shortly after its formation in 1890, the P&E turned over its entire line of railroad from Indianapolis, Indiana to Pekin, Illinois to The Cleveland, Cincinnati, Chicago & St. Louis Railway (Big Four) under an Operating Agreement (Agreement) dated February 22, 1890. The Agreement was assigned to the New York Central Railway Co. (New York Central) in 1930 under a 99-year lease by which the New York Central undertook the use and operation of the properties of the Big Four. Penn Central operated the P&E from February 1, 1968, as successor by

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merger of the New York Central, until April 1, 1976 when all of the rail properties of the P&E were conveyed to the Consolidated Rail Corporation (ConRail) pursuant to § 303(b) of the Regional Rail Reorganization Act of 1973, 45 U.S.C. § 744(b).

Under the Operating Agreement, the Big Four, and subsequently, the New York Central and Penn Central, undertook the operation and maintenance of all of the properties of the P&E, including its line of track, rolling stock and equipment. The Agreement required the Big Four to assume all the expenses of the line, including any amounts attributable to depreciation, and to pay annually to the P&E an amount equal to the net revenues derived from its operation within sixty days of the end of the calendar year. Interest at the rate of 6% annually was to accrue if payment was not made within the sixty-day period. If the expenses incurred in operating the line exceeded the revenues derived therefrom, the Big Four was to be reimbursed from subsequent annual earnings, together with interest at 6%.

The Operating Agreement was substantially similar, in purpose and effect, to the long-term leases which formed the basis of nearly 50% of the Penn Central system.[1] Under the Agreement, the properties of the P&E were operated as an integral part of the Penn Central system, and as though it had been wholly owned by Penn Central. From the date of the original Agreement in 1890 until the conveyance of its properties to ConRail in 1976, the P&E performed no rail services whatsoever, collected no revenues from rail operations and paid none of the costs of operating and maintaining its rail properties. Although

1. An excellent explanation of the development of the Penn Central and its predecessors through the devise of the long-term lease is provided in In re Penn Central Transportation Co., 382 F. Supp. 821 (E.D. Pa. 1974).

it maintains a separate corporate existence, all of its corporate and legal obligations have been assumed by Penn Central, which remains primarily liable for their payment. The employees who provide service over P&E's lines are covered by Penn Central's labor agreements and paid from Penn Central's payrolls. Since 1890, the P&E has functioned merely to collect an annual, but contingent, payment from Penn Central or its predecessors which it distributes to its stockholders.

The Penn Central Trustees have been of the opinion that the P&E's status under the Agreement and as part of the Penn Central system is substantially identical to that of Penn Central's leased lines. With the authorization of the Reorganization Court, the Trustees have made no payments to the leased lines pending a determination of whether to affirm or disaffirm the leases under § 77 of the Bankruptcy Act, 11 U.S.C. § 205.[2] *See In re Penn Central Transportation Co.*, 382 F. Supp. 821, 828-30 (E.D. Pa. 1974). Similarly, no payments have been made by the Trustees to the P&E under the Agreement since the Penn Central entered reorganization in June, 1970.

Although Penn Central currently owes $5.8 million under the Agreement, P&E is not in Reorganization and its financial posture appears to be secure for the foreseeable future. Approximately 80% of the outstanding stock of the P&E is either directly or beneficially owned by Penn Central, through its direct ownership of 30% of the P&E and through its control of the Big Four which owns 50% of the company.

---

2. At the time of the conveyance to ConRail, approximately 50% of the Penn Central system was operated under 44 leases with 41 American and Canadian subsidiaries of Penn Central. Under § 77 of the Bankruptcy Act, 11 U.S.C. § 205, the Trustees are not bound by terms of the leases unless they affirmatively adopt them. *See* In re Penn Central Transportation Co., 354 F. Supp. 717, 732 (E.D. Pa. 1972).

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In 1974, P&E filed a petition with the Reorganization Court to impress a trust upon the assets of the Penn Central in the amount of the payments owed under the Agreement. In its Memorandum and Order No. 1855 denying the petition, *In re Penn Central Transportation Co.*, 392 F. Supp. 960 (E.D. Pa. 1974) (Pet. at A1-A7) the Reorganization Court held that a debtor-creditor, not a trust, relationship existed between Penn Central and the P&E and that there was no justification for payment under the Operating Agreements where the leased lines had not been paid since the commencement of Penn Central's reorganization proceedings. 392 F. Supp. at 964. The Court of Appeals for the Third Circuit affirmed the decision of the Reorganization Court without an opinion. *In re Penn Central Transportation Co.*, 527 F.2d 645 (3d Cir. 1976).

IV

REASONS FOR NOT GRANTING THE WRIT

A. The Decision of the Court of Appeals Affirming the Reorganization Court's Denial of the P&E's Petition Was Not in Conflict With the Decisions of Any Other Court or With Its Own Earlier Decisions

In its petition before the Reorganization Court and in its appeal to the Third Circuit, P&E asserted that the decision of the Court of Appeals in *In re Penn Central Transportation Co., Appeal of Indiana Harbor Belt R.R.*, 486 F.2d 519 (3d Cir. 1973), which held that interline balances collected by Penn Central on behalf of the other interline carriers were held in trust and were to be paid currently, compelled a similar conclusion in this case. The Reorganization Court in denying the petition, correctly noted a fundamental distinction between the status of the P&E in the Penn Central system and the relationship between the Penn Central and the other interline carriers:

> Unlike the interline situation, the Debtor does not collect money for the Peoria account for services performed by the Peoria. The Peoria performs no services similar to those provided by railroad's participating in interline movements. . . . All of the "facts and circumstances surrounding . . . the relationship" between the parties supports the conclusion that the Peoria is nothing more than a part of the Debtor's physical plant, for which they are paid "rent" in accordance with the provisions of the operating agreement. 392 F. Supp. at 963 (Pet. at A5-A6).

The facts surrounding this case amply support the decision and orders below. The P&E has not, since its

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formation in 1890, performed any rail services, earned any revenues from rail services or performed any maintenance of its track or equipment. In effect, it has merely "leased" its line of railroad for a period of 86 years to the Penn Central, and its predecessors, for which it was paid an annual charge in the amount of the net revenues attributable to the operation of the line. Thus, the earlier decision of the Court of Appeals relating to the payment of interline balances where two or more active railroads participate in a joint movement of freight was entirely inapposite to the facts which faced the Reorganization Court below and nothing in its opinion was inconsistent with the interline decision.

Similarly, it is misleading to describe the relationship between the P&E and the Penn Central as involving a division of earnings. The P&E and the Penn Central were not engaged in a joint enterprise involving the operation of the line in which they divided the revenues derived therefrom. Rather, in consideration of the takeover of the operation and control of its rail properties, the Big Four and subsequently the Penn Central paid to the P&E, a non-operating entity, an amount equal to all of the net revenues earned from traffic moving over the line. In *Terre Haute & I. R.R. v. Cox*, 102 F. 825 (7th Cir. 1900), which the P&E relies upon in its petition, the Court specifically described the agreement before it as providing for a joint operation:

> The undertaking was, in a certain sense, a joint one; each (party) contributed a part of the means whereby it should be carried out. 102 F. at 833.

On this basis, the court held that an arrangement for the division of earnings had been made by the parties and held that the monies collected by one of the railroads were held in trust for the other.

Terre Haute was effectively rendered *sui generis* by a subsequent decision of the Seventh Circuit in *Louisville Bridge Co. v. Chicago, I. & L. Ry.*, 253 F. 631 (7th Cir. 1918), which dealt with a factual situation which was substantially similar to that involved here. In *Louisville*, railroads using and maintaining a bridge over the Ohio River were required to make annual payments to the owner of the bridge. The bridge company intervened in the receivership proceedings of one such railroad, asserting that an amount owed to it by the railroad under the operating agreement was held in trust by the debtor. The Court held that the bridge company was merely a general creditor of the railroad and distinguished *Terre Haute* by limiting it to the specific facts as interpreted by the *Terre Haute* court. The *Louisville* Court stated:

> The agreement (in *Terre Haute*) expressly provided for a division of the earnings. It is clearly distinguishable from a case covering an agreement calling for a payment as rent of a sum equal to a certain per cent of the earnings.
>
> In the present case, we conclude that the contract was one calling for the payment of rent and that the amount of the rent was measured in a somewhat unusual manner. The agreement did not, however, have the effect of giving to the bridge company a right to any specific money received by its lessee. 253 F. at 635.

Unlike the *Terre Haute* court's characterization of the relationship of the parties before it, the Agreement between the P&E and Penn Central created merely a debtor-creditor relationship in which Penn Central paid an annual

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rental charge for the use of the P&E's properties. The duration and circumstances of the Agreement, as well as the position of the P&E in the Penn Central system, convincingly demonstrates that the conclusion of the Reorganization Court below was the only reasonable one to be made on the facts before it. It is respectfully submitted that the orders below were entirely proper and present no conflict with existing law which must be resolved by this Court.

B. This Case Does Not Present an Important Question of Federal Law

The P&E asserts that the decisions of the Court of Appeals and the Reorganization Court below are inconsistent with an earlier Interstate Commerce Commission (Commission) decision which held that the P&E was an interline carrier, *Wood v. New York Central R.R.*, 286 I.C.C. 373 (1952), and that a decision of this Court is required to determine the rights and status of the P&E in the Penn Central reorganization proceedings.

As a matter of fact, the Commission reached precisely the opposite conclusion in *Wood*. There, bondholders of the P&E requested the Commission to require the P&E to publish joint and through tariff rates with the New York Central, on the grounds that revenues associated with its line would thus increase. In refusing to require the P&E to publish its own rates under the Interstate Commerce Act, the Commission stated:

> (I)t is apparent that the provisions of the act are directed, not to operating carriers, but to carriers actually engaged in the transportation of passengers or property as defined in the act. The Peoria & Eastern is not engaged in such transportation. The operation of its properties is performed wholly by the New York

> Central, and it is enough that the latter files tariffs . . . as provided in the act.
> 286 I.C.C. at 379-80.

The essential feature of the interline system is that one of the participating carriers engaged in a line-haul movement of rail traffic collects freight charges on behalf of the other participating carriers solely as a matter of convenience. Because each of the interline carriers actually participates in the movement, and is owed freight charges by the shipper for that participation, the Third Circuit held that freight charges collected by one of the carriers as agent for the other are held in trust for the others. *In re Penn Central Transportation Co., supra.*[3] The finding of the Reorganization Court that P&E is not an interline carrier, 392 F. Supp. at 963 n. 4 (Pet. at A6), was wholly consistent with both the Commission's decision in *Wood* and the earlier opinion of the Court of Appeals.

Furthermore, no important or substantial federal question concerning the rights of the P&E in the Penn Central reorganization is presented by this case. The Reorganization Court correctly found that the P&E's status in the Penn Central system was essentially that of a leased-line, to which rentals have not been paid pending a decision by the Trustees to affirm or disaffirm the leases under § 77 of the Bankruptcy Act, 11 U.S.C. § 205. The right of the Trustees to disaffirm the Operating Agreement as an executory contract in the reorganization proceeding is well-established. *See In re Penn Central Transportation Co.*, 354 F. Supp. 717, 732 (E.D. Pa. 1972). Moreover, whether the Operating Agreement is affirmed or disaffirmed

3. Both the Court of Appeals' and the Reorganization Court's decision in the interline case contain excellent descriptions of the interline system of accounting. *See* In re Penn Central Transportation Co., 340 F. Supp. 857, 858-59 (E.D. Pa. 1972); In re Penn Central Transportation Co., 486 F.2d 519, 523 (3d Cir. 1973).

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in the reorganization process, the claim of the P&E against Penn Central under the Agreement or for the use and occupancy of its property from June 21, 1970 to April 1, 1976 will be accorded the priority of an administrative claim. *Group of Institutional Investors v. Chicago, M. St. P. & P.R.R.*, 318 U.S. 727, 732 (E.D. Pa. 1972). *Palmer v. Palmer,* 104 F.2d 161, 163 (2d Cir. 1959), *cert. denied,* 308 U.S. 590 (1939); *In re United Cigar Stores Co.*, 69 F.2d 513, 515 (2d Cir. 1934). There is no need for this Court to consider and affirm these well-established principles of bankruptcy law.

V

CONCLUSION

The judgment order of the Court of Appeals affirming the decision of the Reorganization Court which held simply that the P&E was entitled to no better treatment in the Penn Central reorganization than the other leased lines was entirely proper. No conflict between or among the circuits exists and no important federal question is presented by the P&E's appeal. Accordingly, the Penn Central Trustees respectfully request that the Petition of the P&E for a Writ of Certiorari be denied.

Respectfully submitted,

CARL HELMETAG, JR.,
JOHN J. EHLINGER, JR.,
Attorneys for Respondents,
Trustees of Penn Central
Transportation Company, Debtor.

VI

CERTIFICATE OF SERVICE

I, Carl Helmetag, Jr., hereby certify that I have caused copies of the foregoing "Brief of Respondents, Trustees of Penn Central Transportation Company, Debtor, In Opposition to Petition for Writ of Certiorari" to be mailed, postage prepaid, by first class mail on Alan C. Kauffman, Esquire, Obermayer, Rebmann, Maxwell & Hippel, 1418 Packard Building, Philadelphia, Pa. 19102.

Dated at Philadelphia, Pa., this thirteenth day of May, 1976.

_____

Carl Helmetag, Jr.